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Correspondent of The National City Bank of New York

1812

1930

Economic Conditions
Governmental Finance
United States Securities

New York, November, 1930.

General Business Conditions

THE business situation has shown no clear indication of decisive change during the past month. Some signs of improvement can be found, and a number of them are quite encouraging, but none of them is yet important enough to give definite assurance that the turn has taken place.

Since business men had been counting on some sort of a recovery this Autumn it is natural that this failure of their hopes to materialize should have had a depressing effect. As usual, this disappointment has found reflection in the stock market, where prices, which had been holding up on expectations of an early recovery in corporation earnings, have given way to new low levels more in keeping with the revised ideas as to the outlook for corporation profits. And as the market has declined, business sentiment, which is always influenced largely by the market, has had another sinking spell that has tended to put a damper on recovery.

There is no denying that industry and trade have had a great deal to contend with during the past month. Besides the falling stock market and other indications of unsatisfactory economic conditions at home, the political turmoil existing in so many important areas abroad has tended to keep business in a state of uncertainty. Just at the time when the world most needs peace and order and the whole-hearted cooperation of all peoples and classes, we read of contending armies, turbulent parliaments, tariff wars, and similar symptoms of social unrest and mutual suspicion.

All of which would be disheartening indeed were it to be forgotten that such conditions are to a certain extent the usual accompaniment of economic depression. Let those who assert that the present world confusion is unprecedented only remember back to 1921,—Europe exhausted by war and in serious danger of revolution; currencies collapsing; South America and Australia, then as now, acutely affected by the heavy fall in raw material prices; docks and warehouses the world over filled to overflowing with undeliverable American merchandise; banks burdened with protested foreign exchange items; Cuba in moratorium; and in the Far East, Japan suffering from the after-effects of a panic which proved to be the first warning of the coming storm. Yet such conditions, desperate as they appeared at the time, did not prevent recovery, once started, from proceeding at a rate which confounded the pessimists.

If it be true that the problems now pressing for solution, involving as they do such questions as international debts, tariffs, destinies of empire, and readjustment of industry and agriculture everywhere to a new scale of values, are more complex than those of 1921,—and here it would be well to make allowance for the human tendency always to regard current difficulties as the most perplexing ever experienced,—we still see no reason for failing to face the future with confidence. Obviously the full measure of prosperity for all depends upon the satisfactory solution of these problems, but we do not believe that the world need stand still in the meantime. Trade throughout practically all countries has been so depressed that an increase would seem necessary before long if only to take care of the barest needs of consumption.

Depression in This Country Probably at Bottom

Considering the months of reaction now behind us, as well as the depths to which the decline has gone, there can be little doubt but that the depression in this country is scraping bottom. Whether the precise mathematical low point has been reached may be open to question, but we do not believe business is likely to go much lower and we think the next important movement will be upwards. How soon that will take place cannot, of course, be foretold with certainty, as that depends in large part on the degree of help or hindrance accorded the economic forces working to restore the balance. Usually, however, our industrial depressions of a severity comparable to this one have taken the form of a U-shaped curve,—that is, business after passing through

the declining phase has generally moved sidewise for a few months before commencing the climb back to normal.

It will be recognized also that the coming months are not months in which decisive upward movements are likely to be initiated. During the Winter, building construction and outdoor work are naturally slowed down, and traffic and trade over large sections of the country are hampered by the weather. Hence, with large numbers of workers already out of jobs, unemployment seems likely to get worse before it gets better, both by reason of the slack season and the tendency for industry everywhere to reduce costs through greater use of labor saving devices and methods. Such conditions, while calling for whole-hearted public support of unemployment relief measures, should not lead to a distorted view of the business situation. If the falling off in activity proves to be no greater than usual for the Winter season, business can be counted as having made a gain.

Reducing Costs of Production

One of the factors which is gradually building the foundations of a new prosperity is the progress which industry is making in eliminating waste. Under pressure of reduced volume of business and lower prices, business men have been going over their organizations with a fine tooth comb, subjecting every process to a rigid inspection with a view to finding ways and means of improving methods, eliminating unnecessary man-power, and paring costs to the irreducible minimum. And the results are in many cases most impressive. Although business during recent years has been by no means unprogressive with respect to the adoption of improved methods—quite the contrary—it has been found possible to go on and accomplish still more in this direction. Necessity is a keen spur to invention, and it can now be seen that business had been falling into somewhat extravagant and slack habits during the easy days of prosperity. That, indeed, is an old story. With business, as with the individual and the nation, continuous prosperity often leads to deterioration, and we seem to need an occasional spell of adversity to stiffen the backbone, shake off the easy going way of doing things, and get down to serious work.

In view of what is being done in this country in the way of cost reduction it is interesting to note the following statement by H. C. MacLean, American representative of the International Chamber of Commerce, on the situation in Europe:

> **Companies which face heavy short-term debt maturities, large unsold stocks and reduced sales are making energetic efforts to bring costs down proportionately to present price possibilities. Although many difficulties and liquidations are foreseen for the less efficient and the less fortunate, already the duration of the period of readjustment is being shortened by the alacrity with which hitherto unreached cost levels have been arrived at.**

Thus the cost of business recession is not entirely lost. Economies which it has stimulated will show up in increased profits once revival begins, and business will emerge from this period revitalized and in better shape than ever to move forward. Meantime, economies of operation, showing up as they do in lower retail prices, are assisting revival by tending to offset the reduced purchasing power of large sections of the population. Anyone who doubts this should take a day off and go through the stores to convince himself of the markdowns that have taken place. Nowhere are the fruits of reduced costs more strikingly illustrated than in the automobile industry, where new and deeper cuts into price lists are being announced, notwithstanding the remarkable record already achieved by this industry in this respect.

If the question be asked, does not all this emphasis on economy throw people out of work and thus intensify the unemployment problem, the answer is "Yes—temporarily." This, however, has always been the first price of progress. The thing to bear in mind is that any cheapening of the costs of production which lowers prices and broadens the market prepares the way for an expansion of industry which eventually provides not less, but vastly more, jobs than under the old methods. Witness, for example, the enormous expansion of the printing industry following the introduction of the linotype machine, which originally threw many hand type-setters out of work and was opposed as "contributing to unemployment." And the illustration might be repeated for countless other industries as well. The whole development of modern business is a continuous story of increasing industrial efficiency, lower costs, wider markets, and increasing variety of products. Nor should it be forgotten that the high wages paid to labor, of which we are justly proud, have as their very basis that high production per man which comes from having the fewest possible workers engaged to do a given job.

The Question of Overproduction

If at this point the further objection be raised that business everywhere is already overdone, with no room for additional expansion to absorb these workers, our answer is that we are decidedly skeptical of this theory as to the saturation point. The idea that business in this country has reached such a point of over-development as to afford no more opportunity for the constructive employment of capital is a periodic one and has ever proved to be false. That business has been overdone

in some lines is unquestionably true, and this has disturbed the balance, thrown people out of work, and caused a slowing down of consumption which has given the impression of over-development in all lines. To cure these particular maladjustments takes a little time, but when that is done we are inclined to believe that the wants of the American people will be found to be as far from satisfied as ever. Apparently the United States Steel Corporation, which is spending millions of dollars on plant expansion this year, does not subscribe to the doctrine of the saturation point, nor does Mr. Samuel Insull, who has recently announced a program of expending $200,000,000 on public utility development in the Middle West, nor do the projectors of the vast net work of gasoline and natural gas lines being extended over the country, nor the promoters of various other constructive undertakings who have the courage to go forward when others are hesitating. The truth is that a large part of our expenditures of capital go to rebuilding and re-equipping the industries to keep them up-to-date and maintain their efficiency at the highest possible point. Approximately 80 per cent of the locomotives in use on the railroads of the United States are ten years old or over, and 35 per cent are over 20 years old. Considering the rapid increase in locomotive efficiency during the past ten years, this means that a large part of our railroad motive power is too obsolete to render economical service. Here is but one example of an opportunity for employment of capital. We do not doubt there are many others.

Evidences of Better Business

In the opening paragraph of this issue, we referred to the existence of a number of signs pointing towards better business. Commodity prices have shown more stability, and lately, in particular, the principal staple crops, including cotton and grain, have demonstrated an ability to move independently of the stock market, holding firm in the face of stock market weakness. Towards the close of the month cotton especially has shown strength, with December contracts touching 11½ cents, up 1.34 cents from the low point. Consumption both of raw cotton and raw silk increased in September over August, and exports of raw cotton from the United States during the month were the largest for that period since 1913. Total exports of wheat (including flour) for the season to October 23 from the United States and Canada were 142,000,000 bushels against 100,000,000 bushels a year ago.

Pronounced improvement has taken place in the textile industry, and sentiment there is more optimistic than in years. As indicated in further detail in the special article on the textile industry contained in this issue, production has at length been brought within the bounds of sales and shipments, and with the prospect of eliminating night work in the mills it is hoped that the evils of the chronic overproduction that has plagued the industry can be avoided in the future. Similarly, the lumber industry, which earlier in the year was producing in excess of demand, and piling up inventory, shows curtailment beginning to be effective.

Sugar is up 45 per cent on indications that for the first time all principal producing areas are alive to the need for curbing overproduction. Rubber has been firmer, with reports of a decline in tapping in the Far East during September. While consumption of rubber has been declining, and stocks of crude rubber are large, stocks of tires in the hands of manufacturers are 19 per cent under a year ago. In copper, which up to now has continued to be produced in excess of market requirements, hopes of curtailing excess output have been fostered by the recent arrival in the country of representatives of Belgian copper mining interests to discuss curtailment.

The somewhat better showing of building figures in September has also been regarded favorably, both permits applied for and contracts awarded showing increases as compared with August in contrast with the usual seasonal decrease, with gains being especially noticeable in residential construction. Figures, moreover, for October through the 17th appeared to confirm the uptrend, daily average contract awards running 23 per cent ahead of September and only 8 per cent under October last year. Those, however, for the week of the 24th proved disappointing, and unless followed by a pickup in the final week, will impair the month's showing considerably. Structural steel awards, on the other hand, have continued active in October, running in excess of 40,000 tons weekly in the latter part of the month.

Production in the automobile industry, while low, has shown signs of moving counter to the customary seasonal down-trend. With dealers' stocks of cars greatly reduced and with manufacturers offering their new models at unprecedentedly low prices, it is thought possible that expansion of output in preparation for 1931 may come earlier than usual, thus tending to sustain business over the year-end.

As against these more hopeful signs, activity in the steel industry has slipped off steadily during October and at the close of the month mills were operating at about 50 per cent of capacity. Carloadings continue to reflect the known fact of reduced railway traffic, with loadings of merchandise and miscellaneous

freight running 17 per cent under last year, and the lowest for any corresponding period since 1922.

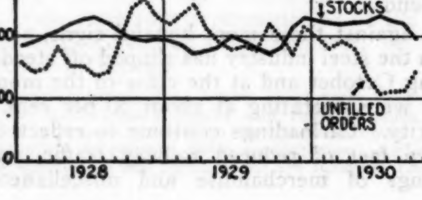
Improvement in Cotton Goods Industry

One of the most encouraging features in the general business outlook is the improvement that has taken place in the cotton goods industry during the past two months. The receipt of large orders, without much speeding up of production, has enabled the mills and their distributing agents to materially reduce the excessive stocks of finished goods on hand and the industry is said to be approaching the soundest condition in years, provided only that production in the future be adjusted so as to correspond with actual demand.

Statistics prepared by the Cotton Textile Institute, Inc., and the Association of Cotton Textile Merchants in New York, whose memberships include a large part of the cotton industry in the United States, show that during the four weeks of September the total production of their mills was 182,385,000 yards. Sales for the same period amounted to 291,980,000 yards or 160.1 per cent of production, and actual shipments to 232,975,000 yards or 127.7 per cent of production. Stocks of finished goods on hand were reduced from 442,996,000 yards on September 1 to 392,406,000 on September 30 or by more than 50,000,000 yards, the largest monthly reduction that has occurred since the compilation of these figures was begun in 1927. Preliminary reports for October indicate a continuance of this favorable trend.

The two-seasonal character of sales, as well as the accumulation of stock early this year, and the recent improvement may be seen from the chart below which embraces the operations of the identical groups reporting to these associations during the past three years.

Cotton Goods—Thousands of Yards (per month)

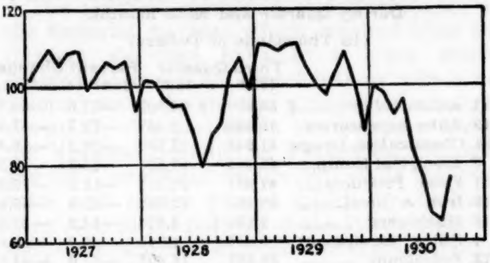


One of the chief factors in correcting the state of over-production, which until recently has prevailed in the cotton goods industry and made satisfactory profits practically impossible, is the concerted movement since the first week in May for the elimination of night work by women and minors under eighteen years of age, which it is hoped will gradually put an end to the night shifts that some mills have been running and eventually place the entire industry on a single shift, daytime basis. This practice of running night shifts was introduced during the war as an emergency measure but has been continued by some mills in an effort to lower costs and meet competition, thus increasing the potential plant capacity of the industry and upsetting the normal balance between supply and demand.

There is no standard ratio for the rate of industrial operations to plant capacity, for this fluctuates in accordance with demand and other conditions. "Capacity" is itself a theoretical figure, based on estimated or arbitrary calculations and subject to the almost universal tendency to over-state by including obsolete and high-cost plants. Over a period of years, however, total capacity of an industry averages considerably above actual output, due to the fact that all departments of a plant are seldom running full at the same time, and that some reserve capacity must be carried to meet peak demands. Moreover, the periodic shutdowns for vacations, taking inventories, overhauling and rearranging machinery and changing the style of product serve to further reduce this operating ratio. In the steel industry, for example, the average rate of output to theoretical plant capacity over the fifty years from 1880 to 1929 has been around 68 per cent, and averaged above 90 per cent only in the years 1917 and 1918. In the automobile industry there was some talk at the beginning of last year of a possible production of 8,000,000 cars and trucks, and there is doubtless plant capacity to make this possible, but the new high record of 5,358,000 vehicles actually produced represented only 67 per cent of this possible capacity, while the estimated output of 3,600,000 this year would be at the rate of only 45 per cent.

In the cotton goods industry, however, the continuance of night shifts after the war has maintained production close to capacity and in some years, notably 1927 and 1929, considerably above. The following chart shows the percentage of active spindle hours based on single shift capacity, as reported by the Department of Commerce, during the past four years.

Cotton Mill Activity—Active Spindle Hours Percent of Single Shift Capacity



Excess of production over actual demand in recent years has not been large, but it has been enough to cause competitive price cutting on finished goods and to reduce the margin of profit to the vanishing point.

A summary of aggregate results of the business of fifty nationally known cotton mill companies making public reports for the last three years is given below:

Cotton Mill Earnings
(In Thousands of Dollars)

	1927		1928		1929	
Number reporting net profit and combined net profit	45	$23,470	33	$15,528	33	$16,047
Number reporting net loss and combined deficits	5	845	17	3,886	17	4,321
Total number reporting and balance of net profit	50	22,625	50	11,642	50	11,726
Combined capital and surplus at beginning of year		345,630		364,315		377,811
Percentage of net profit on capital and surplus		6.5%		3.2%		3.1%

Actual rate of return was even lower than indicated by these figures, because of the fact that in some instances the earnings are given before certain charges, property accounts are based on costs of real estate purchased years ago at only a fraction of present valuations, and many of the smaller and less profitable mills do not make public any figures whatever.

Profits in the Cotton Textile Industry
From "Statistics of Income," U. S. Treasury Dept.
(In Thousands of Dollars)

	Companies Reporting Net Income		Companies Reporting No Net Income	
Year	No.	Net after taxes	No.	Deficit
1916	1,163	$125,823	173	$2,218
1917	*	*	*	*
1918	1,194	136,979	92	1,159
1919	1,045	214,044	84	2,110
1920	630	124,613	319	29,887
1921	470	63,123	392	35,054
1922	592	93,161	190	12,488
1923	568	97,511	177	6,739
1924	342	25,210	634	68,379
1925	*	*	*	*
1926	520	37,405	541	73,621
1927	672	90,650	308	26,266
10 Years	7,196	1,008,519	2,910	257,921

* Not shown separately.

A more complete picture of the unsatisfactory operating results during prior years may be had from the annual reports on Statistics of Income, issued by the United States Treasury Department since 1916, the latest available being for the year 1927. The figures appear at the foot of the left hand column.

In the ten-year period for which detailed figures are available, seventy-two out of every one hundred American cotton mills, on the average, operated at a profit, and twenty-eight at a loss. Aggregate net income during the ten-year period amounted to $1,372,446,000, on which income and excess profits taxes amounting to $363,927,000 were paid, representing an average tax rate of 26.5 per cent and leaving net profits after taxes, of $1,008,519,000. For the industry as a whole, however, this figure is offset by the deficits of the corporations that reported no net income, which aggregated $257,921,000, so that there was one dollar lost for every four dollars in profit, after taxes.

Dividend payments have been on the decline since 1920 and the great majority of mills have now omitted payments altogether and interrupted a record of continuous dividend payments running back to Civil War times, or before.

Industry Must Hold to Curtailment

The recent turn for the better in cotton manufacturing, which has created in the trade the most hopeful feeling in years, is only a beginning, and will require strict adherence to the policy of holding down production to correspond with demand if it is to be successful in restoring this great American industry to the ranks of the prosperous ones. Part of the reduction in stocks since Labor Day was purely seasonal, and resulted from the increase in orders that customarily comes in the Fall but was about one month later than usual this year. Unless this seasonal element be recognized, the figures are apt to be misleading. Stocks of finished goods on hand are still large and the crux of the whole problem is whether or not the industry will continue to work them down and then raise operating schedules gradually as conditions warrant, instead of reverting to night work and upsetting the balance, as has been done repeatedly in the past when signs of improvement began to appear.

With the present low prices for raw cotton, the cost of raw materials for spinners is much cheaper than a few months ago, but prices of finished goods have been reduced drastically and are now lower even than in 1926 or 1921. As a result, the margin of gross manufacturing profit has continued narrow and in the case of most mills is only slightly, if at all, more than sufficient to meet labor costs and other operating expenses and taxes.

Both the Cotton Textile Institute, Inc. and the Association of Cotton Textile Merchants of

New York are making firm appeals to their members and non-members as well, to co-operate in restoring cotton manufacture to a day-time industry, and their efforts are being supported by public sentiment in mill centers both North and South.

Present demand for cotton products is said to be entirely satisfactory and to include practically every important line such as grey goods, print cloths, shirtings, sheeting and dress goods, also fabrics for industrial uses, although export trade is still quiet and the tire fabric and cord branch of the industry is curtailed with the automobile industry. It is true that rayon production has expanded very rapidly during recent years and to some extent has displaced cotton, but it has also helped the cotton industry by making possible the introduction of rayon and cotton mixtures in new and attractive patterns, thus meeting the style competition of silk and other fabrics.

Business Profits

During the past month some two hundred reports have been published by industrial corporations covering profits in the third quarter, and the showing is about as had been expected in view of the curtailed activity in business and the decline in the commodity price level. Net profits of the group during this period aggregated $217,927,000 (after deducting 37 deficits amounting to $7,820,000), which was lower than in either the first or second quarters of this year and makes a particularly unfavorable comparison with the third quarter of 1929, when profits were unusually high and amounted to $403,112,000 for the same companies. This gives a decline of 45 per cent for the third quarter. For the nine months' period, there was a decline from $1,172,085,000 to $781,914,000 or 33 per cent.

Although the number of reports published to date is hardly sufficient to accurately measure the trend in profits of business as a whole, and many large and representative companies do not issue any quarterly figures but only an annual statement, we are giving below a preliminary summary of the reports now available as a matter of interest. It must be kept in mind, however, that the showing of particular industries might be modified to a considerable extent if the data regarding numerous other important concerns could be included. Net profits are shown after all charges but before dividends (except in a few cases where charges, such as depreciation, taxes, etc., are not made until closing the books for the year) for the third quarter of 1929 and 1930, with the percentage change for the quarter and the nine months.

Net Profits of 200 Industrial Corporations in Third Quarter of 1929 and 1930, With Percentage Change During Quarter and Nine Months

(In Thousands of Dollars)

		Third Quarter 1929	Third Quarter 1930	Percent Change Quarter	Percent Change 9 Mos.
11	Automobiles	$ 84,990	$ 36,003	—57.6	—44.3
19	Auto Accessories	10,486	2,867	—72.7	—47.8
14	Chemicals & Drugs	41,945	29,700	—29.2	—16.4
6	Electrical Equip.	25,605	17,331	—32.3	—20.3
21	Food Products	41,337	33,373	—19.3	—15.2
18	Iron & Steel	86,165	33,088	—61.6	—40.9
16	Machinery	8,755	3,974	—54.6	—27.4
4	Office Equipment	5,435	3,044	—44.0	—33.0
13	Petroleum	38,607	16,602	—57.0	—41.8
6	Printing & Pub.	7,361	5,526	—24.9	— 5.6
5	Tobacco (Cigars)	2,613	1,759	—32.7	—24.3
67	Miscellaneous	49,813	34,660	—30.4	—27.3
200	Total	$403,112	$217,927	—45.9	—33.3

Earnings during the fourth quarter of 1929 fell considerably below the first three quarters, and the current quarter may therefore be expected to make a more favorable comparison when measured against the results of a year ago. For the nine months' period this year, 28 of the companies tabulated actually increased their earnings over the corresponding period of 1929, and in relation to invested capital the current year's operations have not been as profitless as might be supposed. The net worth, represented by outstanding capital stock and surplus as given in the published balance sheets of this group of companies amounted to $9,168,532,000 at the beginning of 1929 and $10,288,869,000 this year, on which the percentage return of net profits at an annual rate, without allowance for any seasonal variation, was as follows:

Quarterly Net Profits of 200 Industrial Corporations and Annual Rate of Return on Capital and Surplus

(In Thousands of Dollars)

Quarter	1929	Return	1930	Return
First	352,241	15.4	278,272	10.8
Second	439,167	19.2	293,143	11.4
Third	403,112	17.6	217,927	8.5
Nine Months	1,172,085	17.0	781,914	10.1
Fourth	291,317	12.7		
Year	1,463,402	16.0		

It has been called to our attention that some of the reports published during the past month could have been made to show up much better had the companies reduced their charges for depreciation, depletion, etc., instead of charging off every dollar possible. The year 1930 is an excellent period for business house cleaning. No company need be blamed for making a poor showing, and experience has shown that it is much better at such a time to courageously write off all possible losses and reduce balance sheets to absolutely sound values, than to defer proper charges to the future in an effort to improve the showing this year.

The Situation in Germany

The political confusion and disturbance of the financial markets which resulted from the German elections have to a great extent quieted down. The apprehensions which developed were due to the unexpected strength shown by the parties on the extreme wings, the National Socialist or Fascist on the right and the Communist on the left, while the moderate and centre parties which by coalition have steered the policies of the Reich since the war, were returned with smaller representation.

No political party has ruled by a majority of its own in Germany since the new Constitution was adopted. Indeed division of the parliamentary body into numerous groups, necessitating coalition government, dates back to pre-war times. It is more or less a feature of Continental politics and it has its roots in greater distinction between social classes of the population. This class distinction has been stressed since the war, so that at present most of the Continental parties have distinct economic programs. In the United States and in Great Britain where these social distinctions have not been elaborated upon as much as on the Continent, the voters find it easier to compromise their opinions at the election, by choosing from between two parties the one which on the whole was preferred over the other, for governmental control, after frankly admitting that the policies to be expected of either did not closely accord with their individual views, but holding that responsible and efficient government required that control should be definitely located in one party organization. Compromise of opinions undoubtedly there must be in parliamentary government, but on the Continent the practice has been for the voters to divide into more numerous groups in the choice of representatives, thus necessitating compromise by the groups to form an effective government. There may be something to be said in behalf of the latter system, permitting greater self expression by the voters, but there is more uncertainty as to what the government will do. It magnifies the influence of factions, as we know ourselves by the power of insurgent groups in the American Congress.

The new Reichstag, composed of more than twenty distinct groups, each of which will want to use its bargaining power to forward its particular aims, seems to be more than usually subject to the results of bargaining, which of course is a very unsatisfactory position for a prime minister. He does not know what he will be able to get out of it or what undesirable concessions he may have to make as the price of getting through the measures which he most desires. A government so situated must not be judged too harshly. It must be practical, and cannot be altogether consistent.

Dissolution of the Old Reichstag

The problem which caused the dissolution of the last Reichstag, thereby forcing the recent election was that of balancing the budget, in other words, providing revenues sufficient to meet the proposed expenditures, and determining what kind of taxes should be levied. In the first place, the numerous groups naturally bring forward a great many proposals for spending money, and the expenditures in the aggregate must be large enough to satisfy at least a majority. This is a little like our procedure in making a protective tariff bill. Then when it comes to deciding upon the sources of revenue a similar problem is presented, except that this time each group maneuvers to save its constituents from as much of the tax-burden as possible. The left wing, which includes numerous groups, ranging from the Communists to the groups of liberal but more moderate views regarding social legislation, is inclined to vote money for social purposes and does not object seriously to reparation payments, provided the funds for the last named purpose are raised by taxes on the rich. They are firmly resolved that there shall be no sacrifices, or lowering of the standard of living for that purpose, on the part of the masses. The idea is strong that surplus incomes, by which is meant the excess above the average of incomes and expenditures, are fair game for taxation for the public welfare and enjoyment, and especially suited for reparation payments. This idea is not absent in other countries. The essence of it is in the theory that all private fortunes, whether in the form of productive or unproductive wealth, are devoted exclusively to the benefit of the owners—an utterly unsound theory. The truth is that private capital, by whomsoever owned, which is devoted to production and the development of industry, is serving a social purpose as truly as though owned by the State. Experience has demonstrated that industry is carried on far more efficiently by private ownership than by political management, and the rapid advance of the science of production in recent years, with a resulting rise of the standard of living for the masses, is proof of the social benefits of capital accumulations in private hands, and of the stimulus given to individual effort by the rewards of private initiative and management. However, politics in all countries is much the same, and the pressure of hard times in Germany, although perhaps little or no greater than in Great Britain or other countries, afforded material for a campaign against the existing Bruening ministry, which is pledged to an honest effort to meet the reparation payments

and also committed to practical policies regarding economy in public administration, protection of property rights, the progress of German industry and the general conservation of those resources which are the basis of national prosperity.

Results of the Election

The result of the election as seen in the increased strength of the radical groups gave alarm both within Germany and without. No doubt the situation was judged too seriously, but alarm easily rises into panic, and for a time it seemed possible that movable capital would leave Germany in amounts large enough to cripple the country. In fact, the German Reichsbank, or reserve bank has lost nearly 700 million reichsmarks in gold and foreign exchange since the election was held two months ago. This shows the danger to the national prosperity of any country of ill-considered attacks upon established national policies and the national credit.

However, the situation has calmed down and very much improved. The parliament met on October 15, and the Prime Minister's address was well received, both by the business public and by the main body of the legislators. In response to a motion of "no confidence," offered by the Fascist group, which if carried would have unseated him, the Social Democratic party (the main body of socialists) came to his support and the motion was defeated by a majority of 82. This is taken as indicating that Parliament appreciates the gravity of the situation and that no hasty or destructive legislation will pass. President Hindenburg is a tower of strength for conservative policies and has the power to dissolve this parliament and bring on another election, if it should be thought necessary. At last, of course, reliance must be placed on the sober judgment of the German electorate.

The hasty opinion has been frequently expressed that Germany was prepared to demand a reconsideration of the Young Plan of reparation settlements, and that this would be a disturbing factor in European affairs. Undoubtedly there is much sentiment in Germany to the effect that the settlement calls for larger payments than are consistent with German prosperity and progress or with the general welfare of Europe, and that they run for too many years. There is a measure of sound social policy in the principle that indemnity payments should not run over into the life of a generation born after the war. It is, to say the least, doubtful policy to lay the basis for resentment and rebellion which will involve future generations.

Status of the Young Plan

However, the responsible government of Germany has taken no step to secure a revision of the Young Plan. On the contrary, it has wisely declared that Germany would not be in a position to take such a step until time had elapsed to afford a fair demonstration of the workings of the Young Plan, and until Germany had first set her own house in order. In other words, that there is an obligation upon her to first adopt sound policies of internal government, placing expenditures upon an economical basis, reforming the relations between the German States and the national government upon the general lines recommended by Mr. Parker Gilbert in his reports; and establishing a system of taxation that will satisfy public opinion that Germany is managing her affairs in good faith and with an honest purpose to meet her obligations. This is a wise policy and all that can be reasonably asked of the German Government at this time. It cannot be expected to defy public opinion, stimulate opposition by taking the position now that a revision of the Plan never will be asked. The Plan itself recognizes that revision may be necessary, and provides the method by which the subject may be opened up and the issue peaceably determined. The German Government disclaims any purpose of taking the initiative at present and that is enough to warrant the conclusion that the subject need not be considered a disturbing factor at this time.

Discussion of the subject cannot be suppressed. It is not confined to Germany. It occurs in London, Paris, New York and in all political and financial centers. The world is in an unsettled state of mind and talks of all possible causes of disorder, but there is ample warrant for saying that the reparation question is not a critical issue. Incidentally, it is pertinent to remark that in all the controversy in Germany over reparations no question has been raised as to the status of German securities which are outstanding in the hands of private investors.

Difficulties of International Transfer

It has to be considered that there has been no convincing demonstration that great payments, exceeding the normal balance of payments can be transferred from one country to another without such serious disturbance of international business relations as would be disadvantageous even to the creditor countries. It is not too much to say that the United States would be better off today if it had not received the large additions to its gold stock which resulted from the war. They became the basis of the greatest period of inflation that the world ever has known and two severe crises —in 1920-21 and 1929-30 have resulted there-

from. The payments which Germany has made upon reparations, while offset by accumulations of wealth in Germany, have actually been transferred, by means of foreign loans, made for the most part in the United States. Opinions may differ upon the practicability of the transfer of the proposed payments under the Young Plan; nobody really knows how they will work out. An important proportion of British business men believe that the pressure upon Germany to export goods to make the reparation payments is one of the causes of the depression in British export trade. The undertaking is an experiment on a great scale.

On the other hand, it should be considered that the principle laid down by the Dawes Committee was that taxes resulting from the war should be as heavy upon Germany as in the countries which were victors in the war. The latter have huge debts which resulted from the war and must pay taxes to meet the interest charges on them while German industry was freed from taxation by the depreciation of the currency. It is true that wiping out this indebtedness was a loss to the creditor class in Germany, but the industries are relieved and the transfer of wealth from one class to another within the same country is not so serious a loss to the country as the payment of the debts from one country to another, as in the case of the debts which the allied governments have engaged to pay to the Government of the United States. Not a step can be taken toward relieving Germany of the reparation payments without arousing an appeal for the cancellation of their debts to the United States. Finally, the cancellation of reparations and debts to the United States would mean that the latter country, which had no responsibility for beginning the war, or any share in age-old antagonisms out of which it developed would be assuming all of the sacrifice of the settlement. No more need be said to convince an unbiased observer that the subject of reparations and international war debts is one of numerous complications, and that the masses of the people in the several countries, looking upon the situation from the various angles of self interest need not be expected to readily reach a general agreement. The one rational conclusion about it all is that nobody will gain by having any more fighting on the subject.

Money and Banking

The money market at New York has continued unusually easy during October, notwithstanding that the month generally marks the peak of the Autumn crop moving and trade demand. Prime open market commercial paper is quoted at 2¾-3 per cent, bankers acceptances at 1⅞, short term Treasury securities at 1.44 to 1.97 and Stock Exchange time loans on securities at 2-2½ for loans up to 90 days and 2¾-3 for 4-6 months maturities. Call money has been 2 per cent all month on the floor of the Exchange, but has gone begging much of the time, and considerable sums have been lent outside the Exchange at below the posted rate.

With the passing of October, little chance is seen for any firmer rates before December, when expanding currency requirements for the holiday trade begin to be a factor in the market.

Reasons for continued ease in money are not difficult to find, as they lie in the reduced state of trade and speculative activity. People everywhere are bending their efforts towards paying their debts, rather than contracting new ones. Lower commodity prices, too, are a factor, in that it takes less credit to finance merchandise movements on a low than a high price basis. Reflecting the influence of these various factors on commercial requirements, "all other" loans of the weekly reporting member banks, generally considered roughly representative of this type of borrowing, stood on October 22 approximately $1,000,000,000 under the total for the corresponding date of last year, and the lowest for the period since 1925.

Similarly, the volume of credit employed in the stock market has undergone a big shrinkage. While it is true that the figures of the banks show no reduction in collateral loans from a year ago, it must be remembered that the banks during the past year were forced to take over a large amount of loans originally made by non-banking lenders and since called, owing to unprofitable rates. If one measures credit employed on the Stock Exchange by the total borrowings of its members from all sources, it will be seen that the aggregate is down from $8,549,000,000 on October 1 last year to $3,481,000,000 on October 1 this year, or a reduction of nearly 60 per cent.

Another evidence of slack trade and lower prices appeared in the disappointingly small increase in acceptances of American banks outstanding at the end of September. While the total of $1,366,734,000 was $27,350,393 greater than at the end of August, the gain was considerably short of normal seasonal proportions and was due principally to credits granted to the Grain Stabilization Corporation against stored wheat. Compared with September a year ago the total still shows an increase, but unless the creation of new credits during the balance of the season is greater than now seems likely there is prospect that the record of gains recently shown each year in acceptance totals may not be maintained in

1930. The following table gives the figures of acceptances outstanding as of September 30, this year, August 30, this year, and September 30, last year, classified according to the nature of the credit:

Acceptances Outstanding
Classified According to Type of Credit
(In Million Dollars)

	Sept. 30, 1930	Aug. 30, 1930	Sept. 30, 1929
Imports	241	255	328
Exports	363	357	397
Domestic	27	26	17
Warehouse Credits	174	145	137
Dollar Exchange	63	54	46
Based on goods stored in or shipped between foreign countries	499	501	347
Total	1,367	1,338	1,272

Notwithstanding the low level of commercial borrowing and liquidation in the stock market, the total of loans and investments of all kinds of the weekly reporting member banks has continued to increase, and in October was not only larger than in any previous month this year, but was approximately $488,000,000 greater than in October last year. This increase in total credit has been due in the main to continued rapid rise in bank investments, which in October reached a new high record up $1,273,000,000 from a year ago. Following is a table giving the comparative totals of loans and investments, as of October 22 this year and the corresponding date a year ago:

Loans & Investments of Weekly Reporting Member Banks
(In Million Dollars)

	Oct. 22, 1930	Oct. 23, 1929	Change	Percent Change
Secured Loans	8,142	7,920	+ 222	+ 2.8
All Other	8,573	9,580	—1,007	—10.5
Total Loans	16,715	17,500	— 785	— 4.5
U. S. Gov. Securities	3,060	2,654	+ 406	+15.3
Other Securities	3,607	2,740	+ 867	+31.6
Total Investments	6,667	5,394	+1,273	+23.6
Loans & Investments	23,382	22,894	+ 488	+ 2.1

Trend of Total Bank Credit

In considering the increase in total credit thus indicated, it should be remembered that these figures give only a partial picture of banking conditions throughout the country, and one which is colored largely by conditions in the larger cities where most of these weekly reporting institutions are located. Hence, to get a true picture of banking conditions for the country over, it is necessary to take the figures for all banks, recently published as of June 30, and compare them with the previous year, as in the following table:

Loans & Investments of All Banks
(In Million Dollars)

	June 30, 1930	June 30, 1929	Change	Percent Change
Loans	40,618	41,512	—894	—2.1
Investments	17,490	16,962	+528	+3.1
Loans & Investments	58,108	58,474	—366	— .6

Here it will be seen that whereas total loans and investments of the weekly reporting banks in principal cities increased by $614,000,000 between July 3, 1929, and July 2, 1930 (nearest comparable dates to above), those of all banks decreased by $366,000,000, the decrease being entirely in loans, as investments showed a substantial increase.

The significance of the difference thus shown lies in what it reveals as to the trend of credit in the large body of smaller banks throughout the country not included in the weekly reports. Apparently the expansion of credit shown by the big banks in the larger financial centers has not been indicative of the trend with these smaller institutions whose credit advances to customers must have been considerably reduced over the past year.

Unfortunately, the statistics for all banks have not yet been given out in sufficiently detailed form to make possible a satisfactory analysis of the changes in bank credit by geographical divisions and types of credit. However, figures for all of the banks which are members of the Federal reserve system have been published, and comprising as they do some 8,300 banks representing approximately two-thirds of the banking resources of the country, present an excellent basis for comparison. Following are the figures, classified according to types of credit and according to location of banks, that is, whether in the central reserve cities of New York and Chicago, in the other reserve cities, or in the country at large outside of these reserve cities:

Changes Between June 30, 1929 and 1930 in the Loans & Investments of All Member Banks
(In Million Dollars)

	Central Reserve City Banks	Other Reserve City Banks	Country Banks	All Member Banks
Secured Loans	+711	+ 54	— 99	+ 666
Other Loans	—406	—310	—395	—1,111
Total Loans	+305	—256	—494	— 445
Investments	+415	+ 43	— 69	+ 389
Loans & Investments	+720	—213	—563	— 56

This table brings out even more clearly the extent to which the credit expansion of the past year has been limited to the larger cities, and particularly to New York and Chicago, where the total increase was $720,000,000. As against this increase, other reserve city banks showed a decrease of $213,000,000, and "country" banks of $563,000,000. In the case of the

central reserve cities, secured loans showed a big increase, caused in part by these banks having to take over advances previously made by corporations direct to brokers, and, while "other" loans declined, this decrease was more than made up by a gain in investments. With the banks in the other reserve cities, on the other hand, the increases in secured loans and in investments were too slight to offset the decline in "other" loans, while with the country banks all classifications in the table declined.

All of which seems in line with the complaint frequently heard that money in the interior is considerably tighter than the low rates prevailing in the central money markets would indicate. Such conditions are in accord with past experience which has been that in periods of marked changes in monetary and banking conditions the effect is first felt by the banks in the larger cities and from them spreads in time to the other banks throughout the country. And this is particularly true in periods like the present when the extreme ease of money is partly the result of Federal reserve open market operations which must of necessity be conducted in the larger money centers.

Character of Banking Assets

One other fact revealed by the statement for all member banks deserves comment—namely, the satisfactory showing of the banking system as a whole as to liquidity, regarding which concern has been expressed from time to time. Judging by much that is said and written on the subject of "frozen" loans, it would appear that a great many people have only the haziest notion as to what proportion of banking assets is represented by collateral loans, real estate loans, etc. For this reason we reproduce the following table showing as of June 30 the detailed figures of loans and investments, classified as to central reserve cities, reserve cities, and country banks, together with the percentage relationship of each item to the total loans and investments.

Thus it will be seen that total loans of all kinds on collateral (excluding loans to banks), constituted 18 to 44 per cent of total assets, depending on geographical classification, with the proportion of real estate loans of all kinds ranging from 2 to 12 per cent. Of the total portfolio of all banks, however, there was $3,905,000,000 of paper eligible for rediscount at the Federal reserve banks, with the amounts for the three great groups of banks ranging individually from $1,000,000,000 to $1,600,000,000. If, in addition, account is taken of the holdings of Government securities that could be borrowed against at the Reserve banks, and the call loans to brokers which, under anything but the most extraordinary circumstances, could be converted into cash, it is apparent that the banks, taken as a whole, or by major groups, have ample liquid resources to take care of any possible need.

The Decline of Brokers' Loans

The decline in the stock market during October was accompanied by a further reduction of $710,000,000 in brokers' loans, bringing the total down to $2,512,000,000 on October 29, the lowest since June, 1926, and only $103,000,000 above the lowest point reached in the 1926 slump. Compared with the days not long ago when the speculative contingent was talking $10,000,000,000 of brokers' loans as the new normal, this marks a reduction of $4,292,000,000, or 63 per cent, which agrees closely with the decline shown in the tabulation published by the Stock Exchange and referred to in an earlier paragraph.

Loans and Investments of All Member Banks—June 30, 1930
(In Million Dollars)

	Total	% of Loans & Investments	Central Reserve City Banks	% of Loans & Investments	Other Reserve City Banks	% of Loans & Investments	Country Banks	% of Loans & Investments
Loans, total	25,214	71	8,079	76	8,532	72	8,602	65
Acceptances payable in U. S.	170	.4	145	1	17	....	7	....
Bills, acceptances, payable in for. cnts.	78	....	48	.5	25	....	4	....
Commercial paper bought in open market	500	1	91	.9	238	2	171	1
Loans to banks—on securities	230	.6	120	1	99	.8	11	....
Loans to banks—all other	305	.9	125	1	128	1	52	....
Loans on securities*	10,425	29	4,721	44	3,348	28	2,356	18
to Brokers and dealers in N. Y.	2,365	7	1,982	19	253	2	129	1
to Brokers and dealers elsewhere	819	2	297	3	431	4	90	.6
to others	7,242	20	2,442	23	2,663	22	2,136	16
Real estate loans—on farm land	386	1	2	....	110	1	274	2
Real estate loans—on other real estate	2,769	8	174	2	1,394	12	1,201	9
All other loans (including overdrafts)	10,349	29	2,651	25	3,172	27	4,527	34
Loans eligible for redisc'nt with F. R. bks.	3,905	11	1,010	9	1,275	11	1,620	12
Investments	10,441	29	2,568	24	3,319	28	4,553	35
Loans and Investments	35,655	....	10,647	....	11,851	....	13,155	....

* Exclusive of loans to banks.

Accompanying this further decline in brokers' loans, secured loans of the weekly reporting banks (including both loans to brokers and to other customers) declined $319,000,000 as well, but remained higher than a year ago at this time.

By way of further analysis of the trend of total bank loans on securities, including not only loans to brokers but also loans extended to individuals direct, we give the following figures from the Federal Reserve Bulletin for all member banks for the "call" dates, classified according as to whether the loans are for brokers and dealers, or to "others":

All Member Banks, Loans on Securities, Classified
(000,000 omitted)

	June 29, 1929	Oct. 4, 1929	Dec. 31, 1929	Mar. 27, 1930	June 30, 1930
Total Loans on Securities....	$9,759	$9,994	$10,148	$10,074	$10,425
To brokers & dealers in N.Y.	2,025	1,885	1,660	2,344	2,365
To brokers & dealers elsewhere	921	939	803	706	819
To "Others"	6,813	7,170	7,685	7,024	7,241

Thus it will be seen that notwithstanding the large reductions that have occurred in total brokers' loans, the volume of bank loans on securities on June 30 this year was actually higher than on October 4, 1929, just prior to the stock market break, a condition which, still existing, continues to excite comment as indicating possibly the necessity for further liquidation.

We do not attempt to pass upon this question, but wish to point out the fallacy of measuring stock market credit in terms of bank credit alone, particularly over a period during which so large a part of the market's funds have been obtained from other sources. Our readers are familiar with the enormous expansion last year in the volume of funds lent direct to brokers by corporations and other lenders under the inducement of high call money rates, and how the withdrawal of a large portion of these funds has thrown the burden of financing the market back upon the banks. Thus, in the face of a reduction of $4,292,000,000 in total brokers loans over the past year, and of $3,407,000,000 in loans for account of "others", loans of New York banks for their own account to brokers have expanded by $439,000,000. Of course, a shift of this sort tends to swell the bank figures, but is misleading unless considered in conjunction with the total volume of funds available to the market from all sources. Hence we present the following table of all member bank collateral loans, amended to include loans for account of "others", as more nearly representative of the situation:

Collateral Loans of All Member Banks, Plus Brokers' Loans from Others
(In Million Dollars)

	June 29, 1929	Oct. 4, 1929	Dec. 31, 1929	Mar. 27, 1930	June 30, 1930
All Member Bank Loans on Securities	$ 9,759	$ 9,994	$10,148	$10,074	$10,425
New York Bank Loans to Brokers for Account of "Others"	2,969	3,907	1,548	1,278	939
New York Stock Exchange Loans from others than New York Banks	1,274	1,472	620	631	566
Total	$14,002	$15,373	$12,316	$11,983	$11,930

To what extent the decline of 22 per cent thus shown in total credit between October 4 and June 30 represents "adequate" liquidation remains to be seen. It is true that this is a considerably smaller decline than that shown by the majority of the stock market "averages," most of which are composed largely of the highly volatile stocks. On the other hand, the bank loans on collateral cover all types of securities, bonds as well as stocks, and, embracing as they do the whole country, undoubtedly include a great many loans which are not of speculative character. They have never fluctuated with the same violence as stock prices or brokers' loans.

In the bear market of 1919-21, member bank collateral loans fell from $6,512,000,000 on November 17, 1919, to $5,250,000,000 on June 30, 1921, or by 19 per cent. Since loans for account of "others" were not a factor at that time it seems reasonable to assume that this represents fairly well the extent of liquidation during that period. Compared with this, the 22 per cent decline in credit shown for the current bear market up to June 30, and since extended considerably, seems quite impressive.

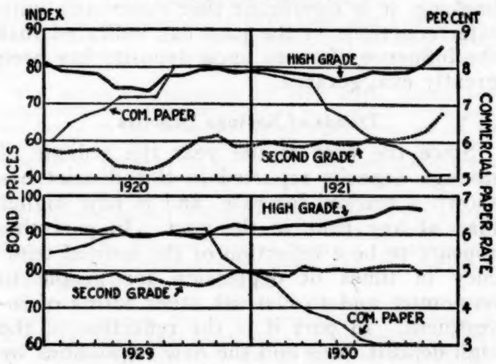
The Bond Market

The bond market has been conspicuously weak during most of the past month. There has been some unsettlement and forced liquidation of domestic issues accompanying the stock market break, while foreign dollar bonds have continued to reflect the current uncertainty over conditions abroad. Ratings on numerous bonds have been lowered this year, removing some from the list of "legals" for savings bank and trust investment. The weakness in general may be ascribed to the prevailing lack of confidence regarding the business outlook which was so apparent during the first three weeks of October. During the past ten days, however, improved conditions abroad and a more hopeful attitude in the United States have brought about a much firmer tone in the bond market.

The failure of bond prices, particularly in the case of second-grade issues, to maintain a steady rate of advance during the past several months has caused widespread disappointment in investment circles. This attitude seems to have arisen partly from a mistaken assumption regarding the normal movement of bond prices during a period of business depression. It is popularly supposed that the bond market tends to advance while business is receding and stock prices are falling, and tends to decline as soon as business and the stock market begin to recover.

A study of past depressions, however, shows that there is little ground for this belief. In the chart below, the movement of bond prices and commercial paper rates in 1929 and 1930 are compared with those of 1920 and 1921. Two indexes of bond prices are shown; one composed of five railroad issues of the highest grade, and one of five strictly second-grade railroad bonds.

Bond Prices and Commercial Paper Rates in 1920-21 and 1929-30



An examination of this chart reveals a good deal of similarity in bond price movements for the two periods. During the first half of 1920, while business was nearing a crisis, the bond market declined steadily. Immediately following the initial break in the stock market, bond prices rallied during the late Summer and Fall and then remained practically unchanged for about ten months. Even though interest rates were falling steadily throughout this period, high-grade bonds, as well as second-grade issues, were unable to advance until the Summer of 1921, when business and the stock market began to turn upward.

A similar situation has prevailed during the current depression. After a sharp rally in November and December of 1929, the bond market as a whole has remained relatively dormant throughout the past ten months. The chief difference as compared with 1921 is that bonds of the highest grade have been able to score a steady, though gradual, advance since last January. The explanation lies chiefly in the fact that in 1921 the banks were able to liquidate their loans relatively slowly and thus were not in a position to increase their investment holdings until the latter part of that year, while in 1930 the banks have had a surplus of funds in a cheap money market and since February have been steadily absorbing the high-grade, seasoned issues.

It is important to distinguish between the highest grade bonds, which are carried by banks and other institutional investors on a more or less riskless basis and whose price movement reflects primarily the changes in money rates, and the second-grade bonds, which contain a risk factor and, like common stocks, reflect both interest rates and the vicissitudes of business. During periods of business recession, it is only the bonds with the greatest security and assurance of continued interest payments that can move counter to the general downward trend. For second or third-grade bonds, as well as for common stocks, the lack of confidence regarding the outlook for earnings is usually the dominating price factor, although greatly accentuated in the case of equity stocks.

In other words, what the bond market needs at the present time more than anything else is an upturn in business, accompanied by a revival of public confidence. Unusually cheap credit since the first of the year has made possible a gradual advance in the market for high-grade bonds, but this factor cannot be expected to have any marked influence upon second-grade issues until public confidence begins to return. With the present outlook for a continuance of easy credit conditions for an indefinite period, it appears safe to say that the recent weakness in the bond market marks a temporary halt in a broad upward movement rather than a major change of trend. On the basis of past experience, bond prices may be expected to advance hand in hand with the stock market for a considerable length of time after business has begun to recover.

Reduction of Interest Rates on Deposits

The recent reduction of interest rates from 4½ to 4 per cent by a group of the large savings banks in New York City has again made pertinent a discussion of the general question of interest rates on time and savings deposits. While the Clearing House Banks in New York City have already taken action to bring short term deposit rates in line with current money conditions, and similar action has been taken in certain of the other reserve centers, there has thus far been no general movement over the country of this character, especially with regard to time deposits, where high interest rates are unfortunately still the rule.

The question as to the unsoundness of the levels to which deposit rates have been pushed in recent years is not a new one, but was the subject of growing discussion about two years ago. At that time the recovery of security prices after the war had brought the yield obtainable on high grade investments to the lowest levels since 1912. Meantime, due to the keen competition existing in the banking field, rates on deposits had not only failed to reflect this decline but in many localities had been advanced to still higher levels. As a result of these opposing tendencies many banks were experiencing increasing difficulties in making both ends meet, and in many cases were able to do so only at the cost of impairing the quality of their investment portfolios.

In view of these conditions, this bank, in company with others, urged at that time a reduction in deposit rates to sounder levels. Unfortunately, before anything could be done, the stock market boom swept over the country, carrying money rates to new high levels and subjecting the banks to a new and more formidable competition—the lure of profits in the stock market. Thus the move towards lower interest rates was checked, and savings banks in this city which had not already done so advanced their rates from 4 to 4½ per cent in the vain endeavor to stem the outflow of funds to the stock market. Later the additional concession was made of crediting interest from day of deposit to the day of withdrawal, instead of only for full quarters as formerly.

Now, however, that the stock market craze has subsided, and interest rates are again seeking lower levels, the question of deposit rates has once more become pressing. With the yields on high grade securities of the character eligible for savings bank investment ranging considerably under 4½ per cent, it is clear that current deposit rates are entirely out of line with the market. It is true that mortgages can be had yielding 5 to 5½ per cent, but requirements of liquidity forbid the investment of more than a certain proportion of a savings in this type of security, the limitations for savings banks under the New York State law being 70 per cent. In the case of some mutual savings banks having large surpluses the maintenance of relatively high deposit rates may be possible for a time, but eventually the rates of these banks too must conform with conditions in the open market.

The issue is clearly one involving sound banking, and where this is the case there ought to be no hesitation in following the proper course. On the average, interest on deposits constitutes nearly half of total operating expenses of banks, and with many small banks having a large proportion of time deposits the proportion is even higher. Thus for most banks, the steadily declining rate of return on investments spells either lower deposit rates or the purchase of interior bonds in the effort to obtain higher yields. The fact that many banks still have some high coupon bonds which they purchased some years ago, or have taken some profits on bond sales, does not alter the situation. Such gains are temporary, for such bonds will gradually run off or be called for payment and have to be replaced on a lower basis. Gains accruing through fortunate original investment should be saved and not dissipated by running the bank on a scale of expenditures not justified by present values.

Every banker is naturally reluctant to be the first to lower rates for fear of losing deposits to his competitors. Yet practically all are agreed that the present rates are too high and are gradually driving the banks into a class of securities that is undesirable for bank investment. If bankers will but face the issue squarely they cannot fail to see the danger, and, seeing it, have the courage to take the steps needed to avoid it. As for the public, which demands above all else conservative banking, it is significant that experience with rate reductions in the past has indicated that the influence of rates upon deposits has been greatly exaggerated.

Trends of Savings Deposits

Since the first of the year the volume of savings deposits reported in this district has shown a marked increase, and is now higher than at any time in the past. In part this appears to be a reflection of the normal tendency in times of depression for people to economize and to distrust other forms of investment. In part it is the reflection of the high deposit rates and the new regulations by some of the savings banks as to crediting of interest, which have had the effect of attracting to savings accounts a large volume of deposits not strictly of savings character.

Of interest also in connection with the savings figures has been the difference in the effects of stock market breaks on savings deposits now and a year ago. When the crash came last Fall, the effect was to cause heavy withdrawals, apparently to protect margins. In the decline this Fall no such decrease has been noted,—in fact, the effect appears to have been to increase rather than decrease savings deposits.

Taxes on Capital Gains

In the address which he delivered before the American Bankers Association in Cleveland on October 2, President Hoover said:

> **I believe an inquiry might develop that our system of taxes upon capital gains directly encourages inflation by strangling the free movement of land and securities.**

This challenge of the tax on capital gains by so high an authority as the President brings the question as to the desirability of changing this feature of the tax law once more to the fore. In our opinion the question is one which may well call for most careful consideration by the public. In a special edition of this Bank Letter, issued in April of last year, and devoted to a discussion of the credit situation, this bank urged the repeal,—or at least the reduction of,—this tax, as contributing to the condition of over-expansion and inflation which then existed and which has since led to such disastrous consequences to all classes of the population.

In emphasizing the unsound features of this tax we cannot do better than quote from our previous discussion of the way in which this tax acted to aggravate the situation in 1929:

It has created artificiality in the security markets, in the credit structure and in interest rates. It has introduced scarcity values in stocks that have spelled high prices and it has created an enormous increase in the loan account. Under these tax laws, and particularly with the surtax operating as it does in the higher brackets, investors and speculators who have large profits in securities have been and are unwilling to liquidate and take profits, but go on holding these securities, leaning on the banks in order to do so.

Not alone the taxpayer of very large means but practically all of the millions of security holders who are taxed in the brackets up to 8 per cent would be benefited by this proposal. Many stocks have increased in value in no small part because holders are unwilling to sell and pay the tax liabilities incurred, even though prices may have gone to excessive levels. The current buyers are therefore forced to pay higher prices by reason of this tax. It is thus apparent that there are two factors involved, namely, the establishment of an artificial price level and the constant increase of the loan account.

If you could check up on the people leaning on borrowed money for the carrying of securities it would be found that there are an overwhelming number of holders who because of this tax do not sell. In our daily experience we find it to be common that men who are holding securities and desire to purchase additional securities in the market which they consider as having an intrinsic value in excess of the market price, do not feel that they can sell that which they have but in the satisfaction of this desire they borrow either through their brokers or directly through their bankers, funds necessary for such purchases, thereby placing added burden on the credit structure.

Instead of having a normal investment turnover, funds once invested in securities that show a substantial profit are locked up indefinitely so that the investor in making new stock purchases as favorable opportunities offer, has no other recourse than to borrow. In this way, the Government, through the tax law, is contributing to the gradual building up of a condition of frozen credit which has thus far defied all efforts to bring about a reduction.

It should be understood that the argument for the elimination of this tax is not based on consideration for the taxpayer. It is true that millions of small security holders, as well as the comparatively few large taxpayers, would be benefited by relief from the tax, and also by the removal of this element of artificiality in the price basis of securities selected for current investment. But it is not on these grounds that the case is presented. The prime consideration is that this tax acts as an obstruction to the free transfer of property, whether it be securities, land, or what not, retards business, and encourages inflation. To our knowledge no other important country levies a tax of this kind upon its citizens except Canada, where the tax is limited to dealers in securities, land, etc.

In his annual reports as Secretary of the Treasury, Mr. Mellon has repeatedly criticized the tax on capital gains, and in the annual report for 1923 indicated a definite opposition to the tax in the following words:

It is believed it would be sounder taxation policy generally not to recognize either capital gain or capital loss for purposes of income tax. * * * In all probability, more revenue has been lost to the Government by permitting the deduction of capital losses than has been realized by including capital gains as income.

In an address before the annual meeting of the United States Chamber of Commerce in May, Ogden L. Mills, Undersecretary of the Treasury, stated that "There is a serious question as to whether the 12½ per cent rate (on capital gains) is not too high."

We also call the attention of our readers to the conclusions reached by the Merchants' Association of New York, following the report of its Committee on Taxation and Public Revenue upon the results of a study of the tax. In a statement given to the press for publication October 15, 1930, this important body of business men denounced the tax and expressed the intention of urging its elimination immediately upon the reassembling of Congress. This statement by the Association is so much in accord with our own views that we reproduce it in part as follows:

This Committee reached the conclusion that not only is the tax too high but that it should be abolished altogether. The Merchants' Association believes that the treatment, under the present law, of gains on capital investments as taxable income in the year within which they are realized, acts to prevent the consummation of numberless transactions essential to the normal growth and development of the country's business. The Government is thus deprived of revenues which would accrue to it if this burden were removed from business and these transactions were consummated with the increase in business volume thus to be expected. It is particularly desirable at this time that any steps which will tend to promote the number of business transactions and, by rendering business more fluid, help to restore normalcy, be considered by Congress.

Government fiscal policy plays a most important part on the business and credit situation. Hence the program should be such as to exert its influence in the direction of sound conditions rather than the reverse. It is to be hoped that Congress will see the situation in this light and correct a fault in the tax structure which is putting the Government in the position of contributing to inflation.